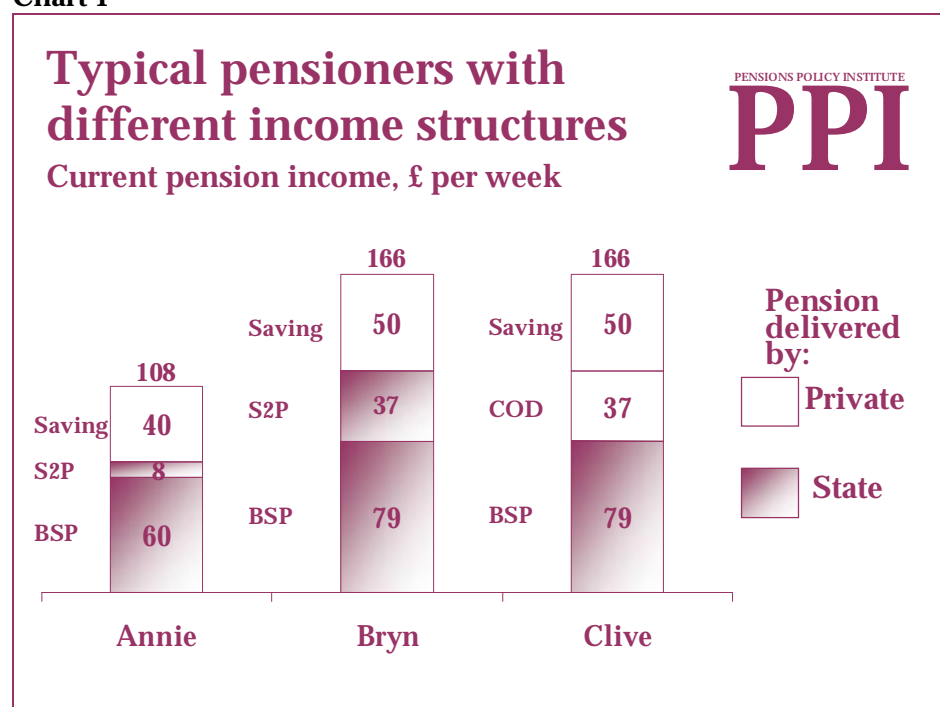


How the offset could work in transitioning to a Citizen's Pension

This note illustrates two options for how to treat accrued rights for Basic State Pension (BSP) and State Second Pension (S2P, or its predecessor State Earnings Related Scheme SERPS) when transitioning to a Citizen's Pension¹.

Suppose we transition overnight – on C-day - to a Citizen's Pension of £105 per week. Take 3 typical pensioners, Annie, Bryn and Clive, receiving different accrued pensions (Chart 1).

Chart 1



Annie is a typical single female pensioner, with less than full BSP, a small amount of contracted-in SERPS/S2P and some private savings that have been accrued on top of SERPS/S2P. The private savings could have come from benefits in an occupational pension scheme or personal pension above SERPS/S2P or any other non-pension saving.

¹ This note does not cover other transition issues.
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Bryn has a full BSP of £79 per week and £37 per week from SERPS/S2P. Both these benefits are delivered by the state as he has been contracted-in throughout his working life. He also has some private saving.

Clive is Bryn's twin. He has had exactly the same work and savings history, but was contracted-out where Bryn was contracted in. This means an equivalent benefit was being accrued in a private scheme (either an occupational scheme or a personal pension). On Clive's annual pension statement from the DWP, there is an item called 'Contracted-Out Deduction (COD)' which identifies the £37 state benefit given up.

The contracted-out portion may be giving Clive a pension income of £37 per week, exactly the same as Bryn is receiving from the state for SERPS/S2P. If the investment performance of the private vehicle into which Clive contracted-out has done well or badly it may be higher or lower than this.

Clive also has the same amount of private saving as Bryn. This could have come from benefits in excess of the COD in his occupational scheme or personal pension, or other non-pension savings.

This note illustrates two possible methods of transitioning to a Citizen's Pension:

1. **Offset:** The Citizen's Pension replaces BSP and S2P. Any pensioner receiving less than £105 from the sum of BSP and SERPS/S2P (or COD) would immediately have that income increased to £105. Any pensioner receiving more than £105 from those elements would carry on receiving the higher amount.
2. **Addition:** The Citizen's Pension replaces BSP only, with S2P accruals paid in full in addition. Whatever amount a pensioner is receiving from BSP increases to £105.

Table 1: Income before and after transitioning to a Citizen's Pension for the three example pensioners, £ per week

	Annie		Bryn		Clive	
	Before	After	Before	After	Before	After
Offset						
BSP	60	} 105	79	} 116	79	79
SERPS/S2P	8		37		37	37 (COD)
Other	40	40	50	50	50	50
Total	108	145	166	166	166	166
Addition						
BSP	60	105	79	105	79	105
SERPS/S2P	8	8	37	37	37	37 (COD)
Other	40	40	50	50	50	50
Total	108	153	166	192	166	192

Chart 2

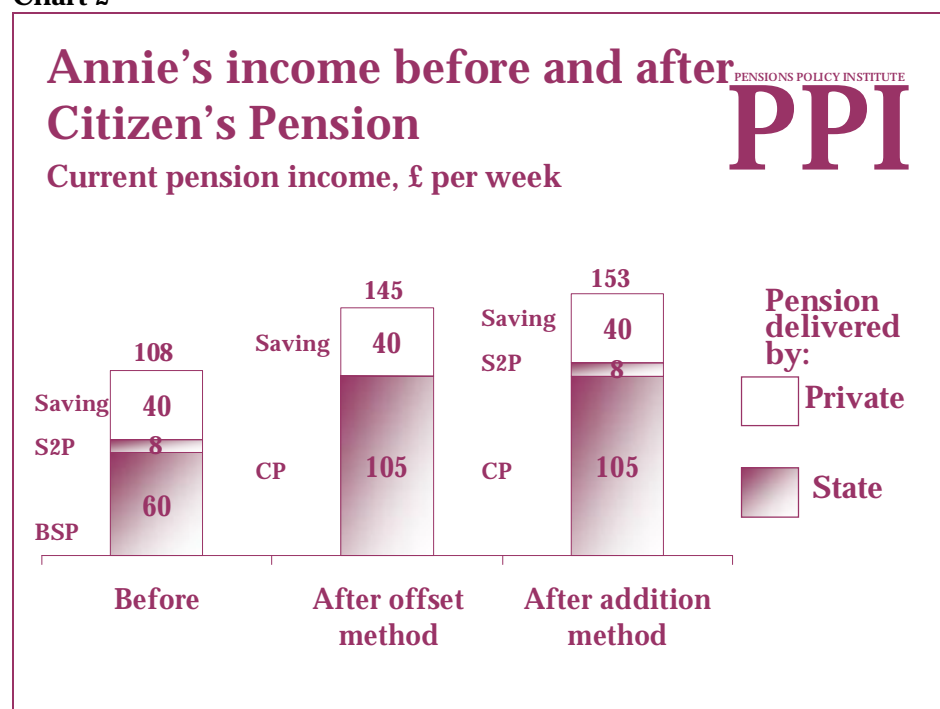


Chart 3

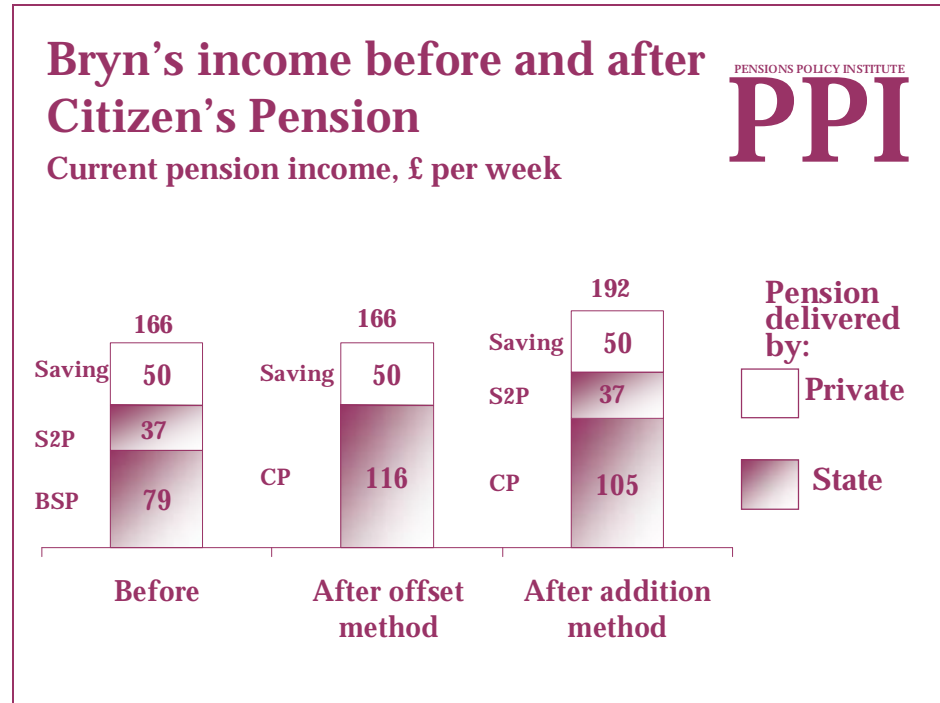
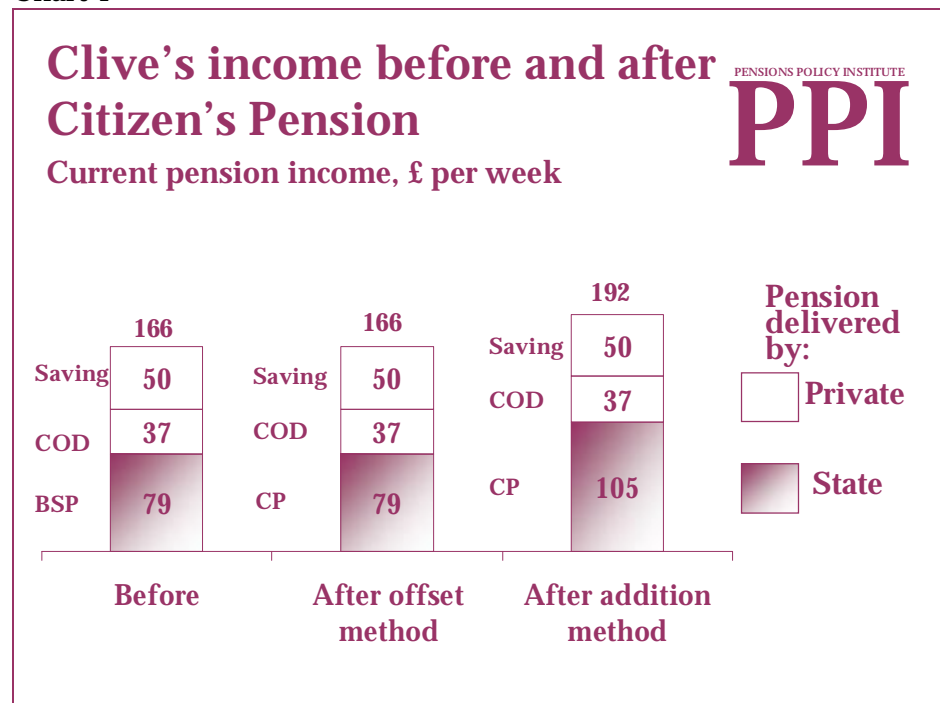


Chart 4



No pensioner faces a drop in state pension income on C-day with either method.

Annie gains as her state pension is lower than the new CP, and she gets an immediate increase up to the new CP level.

Bryn and Clive are in the same situation under the offset method. Their state pension (including contracted-out equivalent in the case of Clive) is higher than the new CP and they carry on receiving the higher amount. In Bryn's case, it will all come from the state. In Clive's case it will come partly from the state, and partly from the private sector (this is the 'COD'). Neither Bryn nor Clive will see any difference in practice.

Bryn and Clive get a big increase in income under the addition method, as their full accrued SERPS/S2P carries on and their BSP is increased to the new CP level.

For all pensioners, the value of private savings continues intact.

The addition method means all pensioners, including those already with high incomes, see pension increases. The offset method ensures nobody loses, and lower income pensioners see some increase.

Therefore the offset method is more progressive and the addition method is more expensive.

The Citizen's Pension is indexed to earnings, but their accrued rights will be indexed to prices. Under the offset method, some pensioners will find that their 'old benefits' drop in value, during retirement, to below the then equivalent of £105. They would then get the current Citizen's Pension.

For people who are not yet pensioners, the calculation is exactly the same, using accrued rights to BSP and SERPS/S2P up to C-day. When these people reach state pension age, their accrued rights are compared to the equivalent of the £105 of the day. The accrued rights can be calculated on C-day and recorded, so that it will not be necessary to continue to take note of NI contributions for the offset method.

Over time, fewer new pensioners would have accrued rights worth more than the equivalent of £105, and eventually every new pensioner will get the Citizen's Pension immediately on reaching state pension age.